SUMMARY of COOPERATIVE CASES

Prepared by

RAYMOND J. MISCHLER, *Attorney*
OFFICE OF THE GENERAL COUNSEL, U.S.D.A.

UNITED STATES DEPARTMENT OF AGRICULTURE
FARMER COOPERATIVE SERVICE

LEGAL SERIES NO. 18 SEPTEMBER 1961

Page

The comments on cases reviewed herein represent the personal opinion of the author, and not necessarily the official views of the Department of Agriculture.

TAXABIE COOPERATIVE MAY BY CHARTER PROVIDE FOR COMMON STOCK DIVIDENDS TO BE PAID FIRST FROM MARGINS ON NON-MEMBER BUSINESS.

(Mississippi Chemical Corporation v. United States of America, U.S.Ct. So. D. Miss., Vicksburg Div. Civil No. 877, Feb. 7, 1961. See also 61-1 USTC - CCH par.9277)

Upon the facts stipulated by the parties in this case the United States District Court for the Southern District of Mississippi found that the charter of the plaintiff, Mississippi Chemical Corporation, hereinafter referred to as the Corporation, constituted a legally enforceable contract between the Corporation and its stockholders and stockholder-patrons and the court sustained and enforced provisions of the charter whereby the common stock dividends were to be paid first from profits on non-stockholder business with only the deficiency, if any, to be deducted from the margins on stockholder patronage.

The court distinguished this charter provision from those involved in A.R.R. 6967, published in C.B. III-1, 287, and Valparaiso Grain & Lumber Co. v. Commissioner, 44 B.T.A. 125. In A.R.R. 6967, the Commissioner had ruled that it must be assumed, in a taxable cooperative in which business is done with both members and non-members on exactly the same basis, that the profits are the same on both member and non-member business. He then held that where a dividend is paid on common stock prior to a patronage refund distribution out of the unsegregated profits, it must be considered as having been paid out of profits realized on business done with members and non-members in the same proportions that the business done with members and non-members, respectively, bore to the total business for the year. Accordingly, he required that the dividend be prorated to the profits realized from the two sources according to the amount of business done with each. Under this computation, the amount available for patronage dividends is only that portion of the profits arising from business with members that is left undistributed after payment of the fixed dividend. In the Valparaiso case, the Tax Court had found this method of computation "fair and reasonable" and sustained its use under the fact presented in that case.

In the current case, the court found the charter provision here involved "materially different" from those considered in A.R.R.6967,

and the Valparaiso case, because in those cases "dividends were agreed to be deducted from the total earnings before the payment of patronage refunds."

The court also found as a matter of law -

(1) that the charter provision constituted a "legally enforceable contract" between the stockholders and the corporation entered into for a valid business reason and that the minimization of income taxes as a result thereof did not effect the enforceability of the provision in the instant suit;

(2) that the sum of $680,825.06 paid by the plaintiff to its stockholder patrons during the four years involved, being the patronage refund paid under the plaintiff's charter contract in excess of the amount which would have been payable under the formula set forth in A.R.R. 6967, did not constitute income to the plaintiff but belonged to its stockholder patrons under their legally enforceable contract with the plaintiff. Such sums were received by the plaintiff as agent or trustee for its stockholder patrons and never became the property of the corporation; and

(3) that the said total of $680,825.06 thus paid to its stockholder-patrons constituted "true patronage dividends" (1) having been paid pursuant to a pre-existing legal obligation, (2) having been allocated out of margins or profits realized from the transactions with the patrons for whose benefits the allocations were made, and (3) having been allocated ratably and equitably between stockholder-patrons who purchased the different types of fertilizer manufactured by the corporation.

That a part of said sum was paid from the profits on non-stockholder business.

The case is being appealed, notice of appeal having been filed April 8, 1961.

# # #

PRICE DISCRIMINATION - COOPERATIVE PURCHASING

(Mid-South Distributors, et al. v. Federal Trade Commission, 287 F. 2d 512 (1961))

This case involved a petition for review of a cease and desist order entered by the Federal Trade Commission against two cooperative buyer groups, Mid-South Distributors and Cotton States, Inc., and their member-jobbers, for having made purchases at discriminatory prices contrary to the provisions of 15 U.S.C.A. 13(f). The Court of Appeals affirmed the order and held that on the total evidence the Commission, applying correct legal standards, properly determined as finder of the fact that the volume rebates through guise of co-operative purchases constituted price discrimination prohibited by the Robinson-Patman Discrimination Act.

The member companies of the association were engaged as jobbers in the sale and distribution of automotive parts and the question involved the price at which the manufacturer-supplier sold to them. The competitors of these member-jobbers were made up of concerns roughly divided into two groups: (a) the large chain stores, the Nationally integrated oil company and tire company outlets, and authorized dealers of the huge automobile manufacturers; and (b) other independent individual jobbers who were neither within (a) nor a member of a co-op buying group.

Petitioners' brief states that they " * * * formed the co-operative associations * * * for the purpose of achieving a measure of competitive parity with their larger, more aggressive rivals * * *", - meaning those in group (a).

The system came into being because of the traditional pricing plan in the automotive parts business. Suppliers had basic list prices. Specified, successfully greater, percentage reductions off the list price were offered to jobbers for specified increases in dollar volume of business. To achieve these graduated dollar volume levels, the purchases for member-jobbers were made by the cooperative. The volume discounts were computed on the basis of the total purchases for all member-jobbers through the cooperative. After deducting the small operating expenses of the cooperative, the volume rebates were distributed to member-jobbers as patronage dividends, the effect of which was to give them a substantially lower cost than would have been paid by an independent jobber.

The petitioners asserted that the effect of the Commissioner's order was to prohibit distribution of net earnings by a cooperative contrary to the provisions of 15 U.S.C.A. 13(b) and that the evidence was insufficient to establish a violation of 15 U.S.C.A. 13(f). The Court asserted that neither the status as a cooperative nor 15 U.S.C. A. 13(b) provided the insulation asserted by the petitioners. Citing various cases, including that of Maryland & Virginia Milk Producers Ass'n., Inc. v. United States, 362 U.S. 458 (1960), the decision stated that 15 U.S.C.A. 13(b) recognizes cooperatives as valid organizations, but does not turn such an "entity loose to acquire on behalf of its members, through the guise of group purchasing, price differentials or other preferences to which each would not be otherwise entitled."

As to the second contention - inadequacy of the evidence to establish an injurious discriminatory price or knowledge thereof - the Court stated that it was proved that a member-jobber obtained substantially the same type and quantity of goods at a price substantially lower than his group (b) independent competitors which hurt those less favored purchasers. This was the exact type of injury Congress sought to prohibit.

The Court stated that so far as the specific element of discriminatory injury was concerned, the Government's section 2(f), (15 U.S.C.A. 13(f)), burden of proof was satisfied by showing price differentials of a kind which would cause or would likely cause injury to competitors, but that where the sections 2(a) and 2(b) lower-cost or meeting-of-competition defenses of the seller were concerned, it was part of the Commissioner's burden in a section 2(f) proceeding of going forward with the evidence to show "that the buyers knew that the seller could not justify the price differential under either one or both."

The Court concluded that the evidence in this case was quite sufficient to show the basis for inferences of buyer knowledge of seller non-justification and that the buyer knew that the seller's pricing schedule did not reflect real savings in cost to the seller.

# # #

MARKETING CONTRACTS - INDUCEMENT TO BREACH - INSUFFICIENT EVIDENCE

(Carolina Milk Producers Association Cooperative, Inc. v. Melville Dairy, Inc., Supreme Court of North Carolina No. 603, Spring Term, 1961.)

In this case the Supreme Court reversed a judgment rendered by the Guilford Superior Court in May 1960, for the plaintiff association, (hereinafter called the Cooperative). (See "Summary of Cooperative Cases", Legal Series No. 17, June 1961) The lower court had held that the defendant, Melville Dairy, Inc., (hereinafter referred to as Melville) had induced members of the Cooperative to breach their contracts with the association. The Supreme Court, however, concluded that the facts did not support the lower court's decision.

The Cooperative was organized in 1953 and membership therein was established by contract by which the members appointed the Cooperative their agent for the purpose of marketing milk. The Cooperative agreed to account to the members (after specified deductions) for all milk which it sold for them and to retain such costs as would be considered a fair part of the Cooperative's operating expenses. The directors fixed 6 cents per hundred pounds of raw milk as a membership fee. Subsequently by a revised contract, designated as B, the members authorized the Cooperative to sell milk in its own name and deal with it as its own; to authorize the purchaser to pay in whole or in part to the producer; or to collect in its own name for all or any part of the purchase price for all milk owned or controlled by the members. In accounting to the member, contract B provided for a deduction of 6 cents per 100 pounds as Cooperative dues, and with certain other small incidentals, the Cooperative was required to account to the member for the remainder. Neither Melville nor any other dairy was a party to the contract.

Melville Dairy, Inc., began operations as a milk processing plant in 1927 and most of the members of the Cooperative had been its customers over the years.

At one time independent truck operators carried the raw milk in cans from the producer's home to the processing plant, but in order to establish closer contact with the producer, Melville bought the truck routes and the trucking equipment and thereafter operated the trucks from the producer's home to the plant. The relationship

between the producer and Melville did not materially change because of producer membership in the Cooperative, except that Melville checked with the members and upon their approval deducted the monthly dues fixed by the Cooperative and transmitted the dues to the Cooperative. After the request for the deduction by the Cooperative and before compliance, Melville obtained the approval of each producer. The Superior Court held that Melville thus recognized the validity of the membership contract. However, the Supreme Court of North Carolina asserted that there is a fundamental distinction between recognizing the contract as valid between the Cooperative and the producer, and consenting to be bound by it. It stated that there was no evidence that Melville acted other than as a courtesy both to the Cooperative and to its members. The Supreme Court held that the collection was a task Melville voluntarily assumed and which it had a right to abandon voluntarily.

When the North Carolina Milk Commission ordered an increase in the price of Grade One Milk in September 1957, Melville decided to put into effect 10 cents per 100 pounds increase in the hauling charge. As an outgrowth of the proposed increase in the hauling charge, officers of the Cooperative initiated a drive to have its members switch from can to refrigeration tanks and the Cooperative discussed plans to purchase tank trucks to take over the hauling. When it became known to the members that the switch would require each producer to make an additional investment of $1,800 to $2,500, dissatisfaction developed, and according to testimony of the members who testified, this proposed switch to refrigeration precipitated the trouble between the Cooperative and its members. Melville's producers began giving notice to the company to cease deducting Cooperative dues. Melville sought the advice of the Milk Commission which advised Melville to "Have something in writing." Thereafter Melville sent a memorandum and ballot to the milk producers inquiring whether or not they wanted the practice of deducting and remitting dues to the Cooperative. Melville stopped making the deductions for those producers who requested that such practice be discontinued.

Thereafter the Cooperative by letter advised Melville either to continue making the deductions or, as an alternative, to send to the Cooperative the check for all milk sold by all members of the Cooperative. The letter also cited the memorandum and ballot as a threat or an attempt to have the member breach his contract. Melville sent out another ballot requesting the members to indicate whether

or not they wanted Melville to send their checks to the Cooperative. Only three members authorized Melville to send their checks to the Cooperative with one later withdrawing his authorization. The requests of the two members were followed.

On the basis of the evidence in this case as summarized above, the Supreme Court of North Carolina held that it failed to perceive that Melville had exceeded the bounds of business propriety and legitimate self-interest either in its dealings with the committee with respect to the increase in the hauling, or its request for written instructions, or its refusal to send each producer's milk check to the Cooperative against the will and direction of the producer who sold the milk.

The court observed that both the Cooperative and the trial judge realized the failure of the evidence to show a breach, but sought to hold Melville upon the ground that its president knowingly attempted to induce members of the Cooperative to breach their marketing agreements. The court noted further that not one member of the Association testified or suggested that the president of Melville or any other person representing the company attempted to induce him to breach his contract. The court asserted that it should be remembered that during the controversy the Cooperative did not sell or offer to sell, a single pound of milk, that the Cooperative did not confer with Melville with reference to any sale, or proposed sale, and that the producer in each instance made the sale of his own product in the customary manner. The court stated that when Melville bought under these circumstances it was understandable why it refused to pay the Cooperative the full purchase price without specific authority from its producers and that "neither common sense nor law required it to violate the producers' specific instructions respecting payment for their own products purchased in the usual course of business." The court noted that in this respect Melville sought and followed the advice of the Milk Commission.

The Court thus reversed the decision of the trial court and ruled that the plaintiff failed to show by facts, and the legitimate inferences from them, that on either of the alleged causes of action it is entitled to recover.

// // //

"AGRICULTURAL LABORERS" AS USED IN NATIONAL LABOR RELATIONS ACT

(Lucas County Farm Bureau Cooperative Association v. National Labor Relations Board. 289 F. 2d 844 (1961)).

The U. S. Court of Appeals, Sixth Circuit, held in this case that employees of a farmer cooperative are to be distinguished from its members and, where they do not engage in farming operations, are not "agricultural laborers" excluded from the National Labor Relations Act.

Lucas County Farm Bureau Cooperative Association, hereinafter referred to as the Cooperative, is a farmers' cooperative association, incorporated under the laws of Ohio, doing business in Lucas County, and engaged in the marketing of grain and processing seed and feed for its members. It also sells retail to its members and to the public certain farm supplies. During the fiscal year 1958 the Cooperative purchased approximately $34,000 worth of coal and lumber from outside the State of Ohio, sold $255,120 worth of grain, $187,000 of which was sold to a grain marketing cooperative outside the State of Ohio, of which the Lucas County Cooperative was a member; and employed 22 employees, including truck drivers, warehousemen and yardmen. Petitioner, the cooperative, as distinguished from its members, did not engage in any farming operations.

The National Labor Relations Board, hereinafter referred to as the "Board", found that the Cooperative violated Section 8(a)(5) and (1) of the National Labor Relations Act, 29 U.S.C.A. § 158(a)(1,5) by refusing to recognize and bargain with the union, the certified majority representative of its employees, and by individually dealing with employees and effecting unilateral changes in conditions of employment without prior consultation with the union. The Board entered a cease and desist order based on those findings.

The Cooperative contended that the Board improperly asserted jurisdiction over its operation, in that (1) it was not engaged in commerce within the meaning of the Act; (2) that the employees in the unit for which the union was certified were "agricultural laborers" excluded from the coverage of the Act, and (3) that its operations did not satisfy the Board's standards for the exercise of its jurisdiction.

Although the Cooperative's interstate transactions were a comparatively small part of its over-all business, the Court found that it was, nevertheless, engaged in commerce within the meaning of the Act. The fact that it is a nonprofit corporation does not exempt it from jurisdiction under the Act. Associated Press v. N.L.R.B., 301 U.S. 103, 128-129, 57 S. Ct. 650, 81 L. Ed. 953.

The Act is not applicable to "any individual employed as an agricultural laborer." Sec. 2(3) of the Act, Sec. 152 (3) Title 29 U.S.C.A. However, the Court noted that the employees herein involved worked for the petitioner corporation, not for its member farmers. The Cooperative was not engaged in farming and none of its employees were engaged in farming or performed any work on a farm. Accordingly, the Court held that the employees were not exempt as agricultural laborers, citing: Farmers Reservoir & Irrigation Company v. McComb, 337 U. S. 755, 60 S. Ct. 1274, 93 L. Ed. 1672; N. L. R. B. v. Edinburg Citrus Ass'n., 5 Cir., 147 F. 2d 353, 354; N. L. R. B. v. Central Oklahoma Milk Producers Ass'n., 10 Cir., 285 F. 2d 495, 497.

The Court found no merit in the Cooperative's contention that its operations did not satisfy the Board's standards for the exercise of its jurisdiction. If jurisdiction exists under the Act, the Court said the extent to which that jurisdiction will be exercised was a matter of administrative policy within the discretion of the Board, citing: N.L.R.B. v. Denver Building & Construction Trades Council, supra, 341 U.S. 675, 684, 71 St. Ct. 943; N.L.R.B. v. F. M. Reeves & Sons, Inc., 10 Cir., 273 F. 2d 710, 711-712; N.L.R.B. v. W. B. Jones Lumber Co., 9 Cir., 245 F. 2d 388, 390.

The petition to set aside the Board's order was denied and a decree of enforcement ordered.

# # #

ADMINISTRATIVE LAW - FAILURE TO EXHAUST

ADMINISTRATIVE REMEDY

(Consumer Co-op Association v. Alex S. Hill, et al
342 S.W. 2d 657 (1951))

This case involved only the technical point as to whether a cooperative, which was trying to obtain a license from a State administrative body, had exhausted its administrative remedies before seeking judicial review of the decision of the State agency. The court held it had not.

Consumers Cooperative Association, a corporation organized under the laws of the State of Kansas, but authorized to do business in Arkansas as a foreign corporation, applied to the Liquified Petroleum Gas Control Board of the latter State for a jobber's permit to allow the association to sell to retail dealers containers for liquified gas products. When the Board refused to grant the license, the cooperative brought a mandamus action in a Chancery Court of Arkansas to compel issuance of the license. The court denied and dismissed the petition and the cooperative appealed.

On appeal, the Supreme Court found that the association, after denial of the application, had failed to resubmit the application as allowed by the rules of the Board. Having failed in this respect to exhaust its administrative remedy, the cooperative was not held entitled to judicial review.

// // //